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The unbearable expense of global dominance

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In 1919, following the first world war and the Treaty of Versailles, John Maynard Keynes wrote his prescient *The Economic Consequences of the Peace*. Keynes was writing about the consequences of peace for the losers. Times now call for a new Keynes to do so again - but this time to write about the economic consequences of the war for the winners.

Politically and militarily, it is profoundly unwise for the US to go it alone in the world. But from an economic point of view it simply cannot do so without seriously damaging the American way of life and standard of living. The US is struggling with very significant domestic problems. It is excessively dependent on foreign capital and foreign energy. The domestic long-term liabilities of an ageing population and unmet social needs are too great to permit the open-ended costs of global military dominance, pre-emptive wars and nation-rebuilding. America needs the Atlantic alliance to help meet the costs of peace - as well as the costs of war - and to sustain economic growth across the Atlantic.

I am no deficit hawk. I believe that, at times, it is not only permissible but necessary to run temporary deficits. Wartime is one such time, recession is another and making up shortfalls in public investment is a third. All of these are present now. Over time, such deficits, especially wartime deficits, could be offset by rolling back existing tax cuts in order to keep federal borrowing from going completely out of control. Such a policy would, over time, alleviate the financial pressures created by growing military peacetime budgets. Instead the government is cutting taxes further while increasing military spending dramatically.

The Iraq war, the recession and stock market losses, together with the tax cuts proposed by the Bush administration have transformed the US budget outlook. Three years after the budget ran a surplus of \$240bn, this year's deficit could rise to \$400bn. The president's recent request for \$80bn for the Iraq war and reconstruction is likely to be a first installment; more realistic estimates run to \$200bn or more over the next five years. In the long run, the picture is dismal. Instead of the \$5,000bn-6,000bn surplus once estimated for the decade ending 2013, the present outlook is for a \$1,800bn deficit, according to the Congressional Budget Office. Estimates of economists outside the government reach as high as \$4,000bn. There are hopes that Iraq's oil revenues will offset most of the reconstruction costs. But it will take several years and billions of dollars to bring production to its full potential.

Then there are America's domestic needs - in particular, unfunded retirement guarantees and healthcare for its ageing population. Further cuts will be required in these areas, weakening taxpayers' appetite for financing reconstruction in Iraq. These facts must also be seen in the context of America's growing dependence on foreign capital to finance its deficits and the impact of its foreign policy on globalisation.

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Financing the country's trade and budget deficits requires ever larger inflows of foreign capital. Its external deficit of about \$600bn annually (a record level) requires financing of \$2.7bn a day in capital inflows. Net foreign debt is now \$3,000bn and growing, requiring ever more foreign investment as a source of capital. With the dollar under pressure, this is a precarious situation.

The spiralling costs of the Iraqi conflict - a brilliantly run, short war against a weak foe - should make clear that another such war and reconstruction, now or later, against North Korea, Iran or even Syria, would be reckless without a different domestic economic policy and strong allied support.

The dollar has fallen 25 per cent against the euro since April last year. So far it has been an orderly decline. However, it could accelerate and, in a dangerous investment climate, foreign investment in the US could come under severe pressure. Foreign direct investment was down to less than \$50bn in 2002 from over \$300bn in 2000.

The recent statements of John Snow, US Treasury secretary, amount to a deliberate - and highly dangerous - policy of further devaluation of the dollar. The Federal Reserve could ultimately be left with a grim dilemma: raise interest rates to protect the dollar and slow the economy further; or let the dollar slide further and run the risk of an international financial crisis.

It is time for the US to stop and think about the contradictory nature of its economic policies and its new international doctrine. It cannot, over time, finance its domestic needs while bankrolling the spiralling costs of America's global military dominance. Something will have to give. A crippled Atlantic relationship will only make matters worse.

The writer is a former US ambassador to France

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